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'Inverted' Principal-Agent as a New Tool to Explain the Implementation of the European Renewable Energy Policy

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Abstract

*The Principal-Agent Model has often been used to explain relationships between national and supranational actors. Its main utility lies in providing an explanation for the process of 'shirking': situation in which an agent fails to fulfill its obligations towards a principal. But so far, in most cases, it is the states that are treated as the principals and international institutions are considered to be agents, whose main task is to fulfill the tasks set for the by the states. In my paper I will present an 'inverted' P-A Model that may be useful in explaining the relations between the European Commission and member states at the stages of the policy implementation. I will argue, that the difference of interests between Brussels on one hand and the national capitals on the other significantly influences the effectiveness of the implementation of the European *acquis communautaire* in the member countries in the area of renewable energy.*

Introduction

With the international relations getting more and more complicated and the role of the formally sovereign countries becoming mostly limited to reacting to changes in the international environment instead of shaping it, it's high time to break with the perception of a country taking action only if it's in its "national interests". In many cases states see themselves forced to implement certain policies that remain in contradiction with the preferences of the major domestic actors: often for their own good.

Many situations, in which countries are forced to act against their (short-term) interests, were preceded by a voluntary transfer of competences to a supranational level. This is what happened in the case of the European integration: process that was started and was for a long time controlled by the member states. But the accumulation of power at the European level has led to situations in which member states see themselves obliged to introduce policies, which they wouldn't have introduced without the pressure from the EU supranational institutions. As a result, they tend to implement the laws that they agreed to at the EU level, in a way that aims at satisfying the preferences of the domestic actors instead of achieving the goals of the laws in the most effective way. That may lead to an implementation of the EU policies in the member states which may be advantageous for those social or economic actors, who are able to influence the policy-making process, but overly expensive for the rest of the population.

In this paper I will describe how the inverted Principal-Agent Model can help to explain the process of implementation of the EU laws in a situation of the discrepancy of interests between the European Commission and the member states. This will be done on the example of the introduction of the EU renewable energy policies in Poland and Germany.

This paper is divided into three major parts. Part one will shortly present the traditional Principal-Agent Model and its two modifications: Principal-Supervisor-Agent Model and the inverted Principal-Agent Model. In the second part it will be shown how this model can be applied to the functioning of the European Union. Finally, in the last part, the usefulness of the inverted Principal-Agent Model will be tested when analyzing the implementation of the EU renewable energy directives in Poland and Germany.

1. The Traditional Principal-Agent Model

The P-A Model is a rather loosely understood concept which has been defined in different ways by different scholars. First applied to explain the relations between the US Congress and regulatory agencies (Tallberg 2003:17), with time it has been more and more often used to explain all situations in which one actor influences the actions of another (Hawkins 2006:9). Such understanding of the principal-agent relationship has been narrowed down by Stephen Ross who defines it as one, that should be limited to a particular domain of decision problems (Ross 1973: 134-139). Hawkins *et al* added further elements that should characterize a P-A Model. According to him the relationship between a principal and an agent should be “limited in time or scope and must be revocable by the principal”. In addition to that “the relations between a principal and an agent are always governed by a *contract*. This contract can have the form of an implicit or informal agreement (Hawkins 2007:7). Jonas Tallberg stresses, however, that the relations between the principal and the agent, although specified in a *contractual framework*, tend to be dynamic and adjusted according to the needs and past experiences (Tallberg 2003:23).

In the international relations the P-A Model has been used to explain the relationship between an organization and the countries which created it. In that case an organization is playing the role of an agent which has been given certain competences to fulfill some tasks in the name of the member states acting as a *collective* principal. There could be various reasons for the transfer of competences to an organization. One of the most common motives for a delegation is the execution of the repetitive tasks that require specific, mostly technical, knowledge. In some cases member states also nominate an agent to confirm their determination to stick to their commitments (Hawkins 2006: 7ff). By giving up some competences governments significantly reduce the probability that they themselves or their successors will default on their obligations in a given area. Such relationships are characterized by a relatively large independence of the agent. In those cases its competences can only be changed by the collective principal acting unanimously or with high majority. Finally, states can also transfer some responsibility to an independent actor to displace responsibility for unpopular decisions in some policy areas (Kassim 2003).

1.1. The Agency Slack

With all its advantages, the transfer of competences to an agent also has its drawbacks. With the time an agent tend to develop its own interests. While fulfilling the tasks given to it by the principal it may tend to take decisions that satisfy its own interests instead of the interests of the founding states. Such action of the agent in pursuit of its own interests has been described by Hawkins as *agency slack*. Hawkins recognizes two primary forms of *agency slack*: *shirking* which takes places, when an agent does not exert enough effort to achieve aims desired by principal, and *slippage*, which can be defined as shifting policies from the direction preferred by the principal towards agent's own preferences (Hawkins 2007:8).

According to Tallberg the precondition for an *agency slack* to occur is the simultaneous presence of information asymmetry and conflicting interests. As he pointed out "Information and interests are the two fundamental building blocks of the P-A relationship." The degree to which the principal and the agent share the same information and the same interests defines the scope of the *agency slack*. The bigger the asymmetry in these both areas, the greater is the possibility of the *agency slack* to take place (Tallberg 2003:19).

While agreeing with Tallberg concerning the influence of the misfit of interests, it is not necessary to deal with the issue of information asymmetry separately: it can be assumed that the asymmetry of information influences the scope of the misfit of interests. If an agent has access to different sources of information than the principal, it will most probably shape its interests. As a result the information asymmetry will be accounted for by concentrating barely on the discrepancy of interests.

1.2. The possibilities to control an agent

The principals are far from being powerless if an agent decides to follow its own interests instead of doing what is expected from it by the member states. First of all, principal can choose another agent whose preferences are more similar to his own. This option is, especially in the field of international relations, not always possible: an international or supranational organization is usually created or chosen by a number of

states with different interests. It is highly possible that the interests of an agent are consistent with the interests of at least one of the member states which will block any action that would change the *status quo*.

Another possibility to limit agency slack is to establish clear rules as the basis of the principal-agent relationship. This can be done either by the creation of a contract that would include detailed instructions specifying what the agent is allowed to do and what not, or to clearly articulate goals and allow agent to figure out what would be the best way to achieve them. The problem with the first solution is that the principal needs to predict all scenarios and provide the agent with instructions how to behave in each possible situation. In the second case it is necessary to provide the agent with more autonomy which will increase the possibility for *agency slack* (Hawkins 2007:29ff).

Another ways to control an agent include monitoring of the agent's behavior, increasing the threat of sanctions if the agent doesn't fulfill its obligations or creating a system of institutional checks and balances. In the latter case these checks and balances can either exist inside the organization itself or the agent may be "blocked" by another agent also controlled by the same principal (Hawkins 2007:29-31). All of those options involve certain costs which in some cases may even exceed the advantages of entering a principal-agent relationship in the first place. Therefore more often than not an agent is granted some independence to follow its own interests when fulfilling its obligations.

2. The Principal-Agent Model and the European Union

At first sight the P-A Model seems well suited to explain the relations between the EU and the member states. The main reason for the creation of the European Union was an attempt to give more credibility to the obligations of the founding states. As a result some competences were transferred to the supranational High Authority that was given some autonomy in executing its tasks of managing the European coal and steel industry. With the time the High Authority, later named European Commission, developed its own interests. What followed was the *agency slack* on behalf of the Commission which in some cases tended to follow its own preferences instead of the preferences of the member states. Also this can be well explained by the Principal-Agent Model.

But a quick look at the possibilities that the member states have to control the agent is enough to see, that the P-A Model has outlived its utility in explaining the relationship between the member states and the European Commission at all stages of the policy-cycle. Instead of limiting its competences when the Commission took initiative in a new area in an attempt to extend its powers, member states changed the Treaty to formalize the extended competences. In contradiction to the traditional P-A Model, it is the European Commission in cooperation with the European Court of Justice that has been given clear competences to punish the member states if they fail to fulfill their obligations.

In a reaction to these deficits, some attempts have been made to adapt the traditional P-A Model to make it more useful in explaining the relationship between the member states and the European supranational institutions. One of the most successful attempts is the Principal-Supervisor-Agent Model developed by Jonas Tallberg. According to this model the member states play both the role of principals and that of agents. In their function as principals they agree on a certain policy and oblige the European institutions, considered as the supervisor, to enforce its implementation in the member states. At this stage the member countries are playing the roles of agents (Tallberg 2003).

The major problem with Tallberg's P-S-A Model is that it treats the European supranational institutions barely as "guardians" of the agreed policies. The Commission has been given powers to punish member states if they fail to implement laws that they themselves had agreed on earlier. Tallberg's focus on supervising the process of implementation can be best explained by his statement that "the EU's supranational institutions have played an independent role in the development of a European enforcement system that is more constraining than national governments ever intended." (Tallberg 2003:1). But the European supranational institutions, especially the European Commission, are much more than barely guardians of the policies agreed by the member states. They are also playing an important role in shaping and initiating these policies.

Another weakness of Tallberg's model is its inability to explain the position of the new member states of the European Union: countries that didn't take part in the policy-making process but after joining the EU had to fully implement European *aquis communautaire*. In this case both the traditional P-A Model and Tallberg's P-S-A Model fail to explain relations between the new member states and the EU institutions concerning the significant number of decisions that were implemented before these countries became

members of the Organization. In those cases the countries were not acting as principals but still constitute part of the Principal-Agent relationship.

These weaknesses result from the attempt to create a model that would simultaneously explain two different things: the process of the European integration and the process of implementation of the European directives in the member states. But the role of the Commission is significantly different in these two processes. Therefore it is necessary to use different models to explain these developments: one that applies to the process of the European integration and another one that can be used to explain the policy implementation.

These two processes can be explained by two P-A Model: one in which the European Commission is playing the role of an agent acting in the name of the member states and another one in which the European Commission is playing the role of a principal which significantly influences the process of creating the obligations for the member states and supervising their implementation. The main difference in comparison to the P-S-A Model developed by Tallberg is the fact, that these two relationships are based on a different legal framework.

2.1. Two P-A Models instead of one

According to the aforementioned definition of the P-A Model, the relationship between the principal and the agent should be based on a contract. In the case of the European Union two types of “contracts” can be differentiated: the treaties regulating the obligations and competences of the European supranational institutions and the secondary law which regulate EU policies in specific areas. Whereas the treaties are negotiated and agreed upon by the member states, in the case of the legal acts dealing with a specific policy the Commission is playing a very important role and was until recently given the exclusive right to initiate a law.

The treaties constitute the basis for the first P-A relationship in which member states play the role of a collective principal and the European Commission that of an agent. In many respects the contract regulating the functioning of the European institutions defines mainly the goals that should be achieved and it leaves the agent with a large degree of freedom concerning the way in which these goals are to be achieved. At the same time there is a

number of ways in which the collective principal in the form of the member states can sanction the agent. In his book Tallberg mentions a number of tools that the member states can use to limit or avoid the agency slack of the Commission. First of all, the ECJ has the power to review the legality of the Commission's actions. Secondly, member states have the possibility to overrule the decisions of the EC or ECJ by new legislation. Further Tallberg mentions "nuclear option", which is altering the mandates of the European institutions by changing the treaties (Tallberg 2003: 33-34).

This vast array of options available to the member states may be misleading. The most obvious sanction in the form of altering the mandate of the agent – which in the case of the European Commission would amount to changing the treaties – is the most difficult to achieve due to the requirement of unanimity. If there is a treaty revision, it usually leads - due to the differences of opinions between the steadily increasing numbers of members - to an *increase* not a *decrease* of the competences of the European supranational institutions.

By giving the European Commission and the European Court of Justice the right to punish the member states in case of non-compliance with the *aquis communautaire* the treaties also constitute basis for the creation of the second principal-agent relationship, one in which the European supranational institutions are playing the role of a principal and the member states that of agents. Since such division of roles is rather unusual in the P-A Model literature and in some respects it differs significantly from the traditional principal-agent relationship, it is useful to call it an *inverted* Principal-Agent Model.

As opposed to the first P-A Model, which illustrates the process of the European integration as a single but constantly changing relation between two actors, there are numerous *inverted* principal-agent relationships: one for each policy in the case of which the EU supranational institutions have the powers to control the process of implementation of the EU laws. The basis for the inverted principal-agent relationship can be a directive that specifies the obligations of the member states in a given area and the scope of autonomy they have to achieve the goals set in the directive.

Intrinsic elements of these two P-A relationships are the discrepancy of interests and the occurrence of agency slack. The Commission in its role of an agent tries to increase its powers and realize policy-specific goals by issuing proposals in policy areas in which its competences were not yet clearly defined. On their part, member states acting as agents are obliged to implement policies which constitute a compromise between 27 different

countries negotiating over a proposal presented by the Commission. As a result there exist a discrepancy between the interests expressed in the final agreement and the preferences of a member country. This leads to the agency slack occurring during the process of implementation of the EU laws: member states implement EU directives in a way which aims much more at satisfying the preferences of the domestic actors than at achieving the goals of the directive in the most effective way.

In both cases the principal is also able to take actions that should limit the scope of the *agency slack*. But there is a significant difference as far as effectiveness of these measures is concerned. Whereas in the case of the member countries a decisive action against the Commission, such as limiting its competences, would require all 27 member states to agree on a change of the treaty, in the case of the inverted principal-agent relationship there are only two institutions that need to reach a consensus to impose financial sanctions on the member states: European Commission and European Court of Justice. As stressed by Tallberg, more often than not these two institutions have very similar interests: Both tend to extend their competences to achieve “more Europe” (Tallberg 2003:28). As a result the European supranational institutions acting as principals in the inverted P-A model can limit the agency slack of the member countries at the stage of the policy implementation much more easily, than the member states acting as principal during the process of the European integration.

The above analysis shows, that the EU policy cycle can be explained as two interconnected P-A relationships, that differ significantly in regard of the scope of the autonomy of the agent, the character of sanctions and the probability of their implementation. As a result the states can not only be understood as agents fulfilling the tasks given to them by the European institutions during the stage of the policy implementation. It can also be said, that their position as principals during the process of the European integration is much weaker, than that of the European institutions playing the role of principals at the stage of the policy implementation.

In the following section I will present how the inverted P-A Model can be used to explain the implementation of the European renewable energy policy in the member states on the example of Poland and Germany.

3. European Renewable Energy Policy

Renewable energy policy is one of the newest policies of the European Union. Contrary to many other policies, in the case of which the competences have steadily been transferred from the national to the European level, in many cases there was no national renewable energy policy in some member states before it has been developed at the European level.

The EU renewable energy policy consists of a number of Communications, Green and White Papers, Regulations and Directives. Out of those only the latter two have binding character for the member states. Since the EU competences in this area are rather limited, directives, which are binding only in regards of their goals but not necessarily the measures to achieve them, are the prevailing binding policy measures used so far.

So far three directives dealing with energy from renewable sources have been agreed at the EU level. Each of them required member countries to introduce some measures which would have a significant impact on their energy policy: area in which member states have their own long-established interests. As a result, the process of implementation of the European renewable energy directives in the member states has been heavily influenced by the misfit of interests between the interests expressed in a directive and the policy preferences of a given country.

In the remaining part of the paper I will shortly illustrate how is it possible that an independent country is agreeing to implement a law which remains in contradiction with the policy preferences of its major domestic policy actors.

3.1. European Commission as the “Policy Entrepreneur”

In contradiction to what would be suggested by some intergovernmentalists, the role of the European supranational institutions in shaping the European renewable energy policy is far from neutral. More than being just a platform used by the member states to facilitate their cooperation (Moravcsik 1993: 22ff), the European Commission has its own interests which result from it being a bureaucracy trying to gain new competences. As pointedly

pointed out by Laura Cram “(l)ike most bureaucracies, the ultimate aim of the Commission is to expand its powers or at least to avoid having its powers curtailed.” (Cram 1997: 156).

The best and already tried strategy used by the Commission to expand its competences is through linkages between different policy areas. This strategy has been successfully employed to create and expand the Commission’s competences in the area of renewable energy. In the Single European Act the European Union has gained new powers in the area of environment. Since large part of the environmental pollution is created during the production and consumption of energy, the Commission saw itself authorized to issue communications stressing the need for support of the alternative sources of energy: still a novelty in the late 1980s and early 1990s. The Commission was also very quick to put the issue of global warming on the agenda: already in its Communication from November 1988 it emphasized the need to deal with this issue at the European level (European Commission 1988). The best solution to deal with this issue was development of the renewable sources of energy.

In its promotion of the more sustainable development the Commission was supported by a number of non-governmental, pan-European actors many of whom benefited either from the expenditure programs facilitated by the Commission back in the 1990s such as ALTENER or from the policies initiated by the Commission which led to the favorable conditions for the development of renewable energy sources.

Apart from trying to increase its competences to a new policy area, in the case of the renewable energy policy the Commission has also been following the goal of framing the sustainable development as the new European project. As stressed by Claude Turmes on numerous occasions, at the time when the construction of the common market is almost finished and the threat of war, which was one of the main reasons for the creation of the European Union back in the 1950s, has largely disappeared, the Organization needs a new reason for its existence. Sustainable development, that also includes development of the renewable sources of energy, should be the major project the realization of which should be the goal of the European supranational institutions. (Claude Turmes at EREC Conference 2010). As pointedly summarized by the UK environment secretary David Miliband,“(t)he needs of the environment are coming together with the needs of the EU: one is a cause looking for a champion, the other a champion in search for a cause” (Buchan 2009:110).

An attempt to increase its competences and reframing its meaning show that the European supranational institutions have some vested interests in promoting the development of the renewable energy sources. But not all goals of the Commission are shared by the member states. Below policies of two countries, with radically different attitudes towards the European renewable energy policy, will be shortly presented.

3.2. Impact on the Member States: The Case of Poland and Germany

The interests and preferences of the European Commission are rarely shared by all member states in the same degree. In the Union consisting of 27 countries it is even more improbable than in the EU-15 or EU-12. With the Eastern enlargement of 2004 the EU gained ten new member states whose energy policies differed significantly from the policies of most of the “old” member states: something that has had a large influence on the implementation of the EU laws in the area of renewable energy policy. The differences in the energy area between the new and old member states become very clear when comparing two states: Poland and Germany.

Differences between these two countries in the area of energy have become especially clear over the last few months. At the time when German government decided to switch-off all nuclear power plants by 2022, Polish government started a nation-wide campaign promoting the apparent advantages of the nuclear energy with the aim of increasing the support for its plans to build two nuclear power plants in this country. While Germany sets itself a target of 40 per cent CO₂ emissions’ reduction by 2020, Polish government is arguing with the European Commission about its demands to reduce Poland’s swelled CO₂ emissions allowances.

These differences continue in the area of renewable energy policy. According to EU directive 2001/77/EC each member country was obliged to implement a support system for renewable sources of energy (European Commission 2001). While Germany continued with its feed-in tariffs system, which due to its stability and predictability has led to a rapid development of the capacity of the renewable energy, Poland with much delay introduced a quota system that make it much more difficult for small actors to establish themselves on the market. As a result of that and a number of bureaucratic barriers Poland failed to

achieve its indicative target resulting from directive 2001/77/EC concerning the share of electricity from renewable energy sources by 2010.

Differences between these two countries can to some degree be explained by the structure of the energy markets in these two countries, especially by the dominant role played by coal in the Polish energy sector. But the major factor influencing the renewable energy policies in these two countries is the political system and its openness to the interests of certain actors who shape the *national* preferences for a certain policy. As pointed out by Moravcsik *national preferences constitute the conflation of the interests of the actors participating in the policy-making process* (Moravcsik 1993:474). At the same time it must be borne in mind, that national interests are not a simple aggregation of the preferences of the domestic actors. Whose preferences will make it to the decision level depends on the political system of a country. As stressed by Moravcsik, the preferences of the domestic social groups are aggregated through political institutions (Moravcsik 1993:481).

The differences between Polish and German national preferences result on one hand from different interests of the actors participating in the policy-making process and on the other from the fact that political systems of these two countries are open to the preferences of different actors. In the case of Poland the large producers of electricity, mainly from coal, have a significant impact on the decision-making process, whereas in the case of Germany the impact of the traditional industry is counterbalanced by the increasingly strong lobby of the renewable energy industry.

3.3. Surprising Compromises

The differences between the preferences of the Polish and German governments in the energy area are an example of the challenge to find a compromise between 27 member countries, each of which has its own interests and preferences regarding certain policy choices. What one could expect in such a situation is either lack of agreement or an agreement that represents the lowest common denominator. But this is not what happened in the case of the most recent directive 2009/28/EC (European Commission 2009). Binding targets for the share of renewable energy in the energy mix and the a number of other obligations that should significantly reduce the role of the fossil fuels in the energy sector is

far more than what many countries would be happy to do. How is then possible that such a deal was possible in the first place and what are the repercussions of that?

Understanding the role of the Commission in the policy-making process is crucial to answer these questions. As already mentioned, the Commission has its own vested interests in the area of renewable energy policy. To reach them it acts as a “purposeful actor” who is not only waiting for a window of opportunity to take action but is also facilitating the emergence of such opportunities (Cram 1997:164f). In the case of the renewable energy policy it took advantage of some countries trying to “upload” their renewable energy policies to the European level. It is not a coincidence, that the Renewable Energy Roadmap calling for the 20% target of RES in the EU energy mix was published in January 2007 – at the very beginning of the German presidency, country whose interests in the renewable energy sector has been very close to the preferences of the European Commission. Two months later the “20-20-20” by 2020 target was endorsed by the leaders of all member states.

Apart from taking advantage of the “windows of opportunity”, the Commission is also using linkages between different issues. Taking into consideration the wide scope of issues that the European Union is dealing with, member states understand, that their veto during negotiations of a given law or measure will make it more difficult to reach a compromise in an area that is important for them. Also the fact that no country would like to be blamed for the collapse of negotiations makes an agreement possible despite significant differences between the interests of the member states.

As a result member states agree on a law, that some of them did not really want in the first place. That leads to a discrepancy between the preferences expressed in a European law and the preferences of those domestic actors, who will participate in the process of implementation of that law in the member states. The scope of the “misfit of preferences” differs between the member states. Whereas some countries managed to “upload” their preferences into a directive (Germany), other agreed because of Commission’s concessions in other areas (Poland). But whatever its reason, the misfit of interests has a great impact on the way a directive is implemented in the member states.

4. The Dual Principal-Agent Model and European Renewable Energy Policy

Actions of the European Commission in the area of renewable energy serve as a good example for this institution attempting to extend its power using the competences given to it in another area: in this case in the area of environment. Using the Principal-Agent Model, such behavior could be very well understood as agency slack: The Commission, acting as an agent, is fulfilling its obligations to take care of the environment in a way which will in the end significantly increase its competences in the area of renewable energy. Member states had difficulty to limit this behavior because the interests of the Commission in the area of renewable energy were similar to the interests of some of the major member countries. The Commission took also great care to frame its actions as part of its climate change policy: issue that can be dealt with much more effectively at the European than at the national level. Finally, in the situation in which the threat of global warming has become the major issue for the European public opinion, punishing European Commission for suggesting steps to combat it would be politically unwise. As a result, the agency slack of the Commission acting as an agent in the first P-A Model proved successful and led to the expansion of the competences of the European supranational institutions to a new policy area.

As mentioned earlier, an increase of powers of the European institutions constitute a basis for the development of the inverted P-A relationships in new areas. In those cases European Commission is playing an active role in formulating a policy and is supervising its implementation in the member states. The directive 2001/77/EC, the first legally binding document which obliged member states to introduce measures promoting electricity from renewable energy sources, constituted the basis of the inverted P-A Model in the area of renewable energy. It defined the obligations of the member states but has also given them a large autonomy in achieving the goals of the directive. This autonomy has been used by some member states to satisfy the preferences of those domestic actors, who were able to influence the policy-making process. The agency slack has been especially clear when analyzing the implementation of this directive in Poland: country in the case of which the misfit between the interests expressed in the directive and the preferences of the domestic actors has been the largest.

This dual P-A Model remains in contradiction with the intergovernmental understanding of the European integration. Member states may theoretically be able to limit

the agency slack of the European supranational institutions, but practically, with the steadily increasing number of decision-makers, and as long as the interest of the European Commission reflect the interests of at least some member states, the countries, acting as a collective principal, will be unable to limit the competences of the agent.

At the same time, with the increase of the competences of the European supranational institutions, the inverted P-A Model in which the Commission in cooperation with the European Court of Justice supervises the process of implementation of the European law that it significantly influenced, gains on importance.

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